32302 #12
UNI-UNI

No. 201.

JUN 28 1944
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

THE UNITED GAS IMPROVEMENT COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

JOHN H. MINDS,
1401 ARCH STREET,
PHILADELPHIA, PA.,

WILLIAM R. SPOFFORD,
1035 LAND TITLE BUILDING,
PHILADELPHIA, PA.
Counsel for Petitioner.

BALLARD, SPAHR, ANDREWS & INGERSOLL,
Of Counsel.

144405

ALLEN, LANE & SCOTT, PRS., PHILADELPHIA.

TABLE OF CONTENTS OF PETITION AND BRIEF.

PETITION.

PAGE

Statement of Matter Involved 2

Jurisdiction 4

Statutes Involved 4

Questions Presented 6

Reasons Relied on for the Allowance of the Writ 6

BRIEF.

Opinions Below 9

Statement of Facts 9

Statutes Involved 9

Specification of Errors 9

Argument 10

I. Introductory 10

II. Petitioner Did Not Exchange its Stock and Unsecured Indebtedness 11

III. The Decree of the Reorganization Court was Binding Upon the Courts Below 13

IV. Conclusion 15

TABLE OF CASES CITED.

PAGE

Case *v.* Los Angeles Lumber Co., 308 U. S. 106 ..... 7, 12, 14

Fairbanks *v.* U. S., 306 U. S. 436 ..... 7, 11

Helvering *v.* William Flaccus Oak Leather Co., 313 U. S. 247 ..... 7, 11

Local Loan Co. *v.* Hunt, 292 U. S. 234 13

TABLE OF STATUTES CITED.

Bankruptcy Act, Section 77B 6, 10, 12

Internal Revenue Code, Section 1141(a) 4

Internal Revenue Code, Section 112(a) 7

Internal Revenue Code, Section 112(b)(3) 7

Internal Revenue Code, Section 112(g) 7, 10

Judicial Code, Section 240(a) 4

Revenue Act of 1936, Section 23(f) and (k) 4

Revenue Act of 1936, Section 112(a) 5, 7

Revenue Act of 1936, Section 112(b)(3) 5, 7, 11

Revenue Act of 1936, Section 112(g) 5, 7, 10, 11

TABLE OF MISCELLANEOUS CITATIONS.

Regulations 84, Article 112(a)-1 12

Regulations 94, Article 112(a)-1 ..... 7, 11

Regulations 101, Article 112(a)-1 12

Regulations 103, Section 19.112(a)-1 12

Regulations 111, Section 19.112(a)-1 12

Restatement of the Law of Judgments, Section 73(1) 13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944. No. .

The United Gas Improvement Company,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your Petitioner, The United Gas Improvement Company, a corporation, by its attorneys, John H. Minds and William R. Spofford, prays that a Writ of Certiorari issue to review the decision of the United States Circuit Court of Appeals for the Third Circuit (R. 156) entered March 30, 1944, affirming the order of The Tax Court of the United States, entered October 9, 1942 (R. 111) redetermining a deficiency in income tax for the year 1937.

STATEMENT OF MATTER INVOLVED.

The United Gas Improvement Company, petitioner herein, is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania. In its income tax return for the year 1937, petitioner deducted the amount of its investment in the capital stock and unsecured indebtedness of Nashville Gas and Heating Company which was reorganized under Section 77B of the Bankruptcy Act during 1937. The deficiency here in question arises from the disallowance by respondent of the deductions so claimed.

Nashville Gas and Heating Company, a public utility operating corporation, was organized under the laws of Tennessee (R. 15). On January 1, 1937, its outstanding capital stock consisted of 8,000 shares of preferred stock and 16,000 shares of common stock, each share having a par value of $100. Petitioner owned all the preferred shares and 15,834.4 shares of common stock. 165.6 shares of common were owned by others (R. 20).

On January 1, 1937, Nashville Gas and Heating Company had outstanding $2,729,000 face amount of First Mortgage 5% Twenty-five Year Gold Bonds, issued in 1912, at which time $6,000,000 were authorized and $2,965,000 were issued (R. 20). Petitioner had guaranteed payment of both principal and interest of the first $2,000,000 of these bonds (R. 16) and on January 1, 1937, owned $37,000 face amount of guaranteed and $40,000 face amount of unguaranteed bonds (R. 20). Prior to January 1, 1937, petitioner had made unsecured loans to Nashville Gas and Heating Company aggregating $522,225 on which no interest was paid subsequent to June 30, 1934 (R. 19).

On July 5, 1935, Nashville Gas and Heating Company filed a petition for reorganization under Section 77B of the Bankruptcy Act, in the United States District Court for the Middle District of Tennessee (R. 20). On June

11, 1937, after a hearing and due consideration, the Court confirmed a plan of reorganization. Under the plan, petitioner was to pay to the trustee of the old guaranteed bonds cash sufficient to pay off principal and interest of these bonds. For this payment petitioner was to receive all the common stock of the reorganized company. Old unguaranteed bonds were to be exchanged, bond for bond, for new First Mortgage Bonds. The plan also provided that the common and preferred stockholders of the old company would receive no distribution of cash or securities on account of stock owned by them. Finally the plan provided that the unsecured debt payable to petitioner would be cancelled and petitioner would not receive any cash or securities on account of such debt (R. 21, 69-74).

Pursuant to the plan, Nashville Gas and Heating Company amended its charter so that its authorized capital stock was $2,000,000 (the amount of old guaranteed bonds) consisting of 20,000 shares of $100 par each, and authorized and executed new First Mortgage Bonds (R. 23). Petitioner (through the mortgage trustee) paid off the old guaranteed bonds (R. 22), received the new stock (R. 23) and exchanged its $40,000 of old unguaranteed bonds for a like amount of new First Mortgage Bonds (R. 23). The debt owed to petitioner was cancelled and the old common and preferred stocks were likewise cancelled (R. 23, 85, 88, 89).

In its income tax return for 1937, petitioner deducted the cost of its investment in preferred and common stock of Nashville Gas and Heating Company as a loss, believing that these shares had become worthless in that year when they were cancelled and nothing was received in exchange for them. Petitioner also deducted the amount of the unsecured indebtedness because the debt was ascertained to have become worthless in 1937 and was charged off in that year.

The respondent disallowed these deductions and was sustained by The Tax Court, three Judges dissenting, and

by the Circuit Court. Both courts took the position that, despite the decree of the reorganization court under which petitioner received nothing for its common or preferred stock or its unsecured indebtedness, and despite the fact that the other common stockholders received nothing whatsoever, the petitioner "in effect" exchanged its stock and indebtedness for new stock of the reorganized company (R. 109, 154).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, 28 U. S. C. §347) and Section 1141 (a) of the Internal Revenue Code. The order of the Circuit Court of Appeals for the Third Circuit was entered March 31, 1944 (R. 156).

STATUTES INVOLVED.

The relevant sections of the Revenue Act of 1936 are the following: Sections 23 (f) and (k), Revenue Act of 1936, c. 690, 49 Stat. 1659, 1660.

"Sec. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

"(f) LOSSES BY CORPORATIONS.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

"(k) BAD DEBTS.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when

satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction."

Section 112 (a), (b) (3) and (g) (1) of the Revenue Act of 1936, c. 690, 49 Stat. 1678, 1679, 1681.

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

"(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section."

"(b) EXCHANGES SOLELY IN KIND.—

"(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

"(g) DEFINITION OF REORGANIZATION.—As used in this section and section 113—

"(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected."

QUESTIONS PRESENTED.

1. Whether petitioner is entitled to deduct from gross income its investment in preferred and common stock and unsecured indebtedness which were cancelled in a reorganization of the issuing corporation under Section 77B of the Bankruptcy Act, pursuant to a plan of reorganization approved by the Court which expressly provided that nothing was to be received in exchange therefor.

2. Whether, notwithstanding a plan of reorganization approved by the Court which expressly provided that nothing was to be received for petitioner's common and preferred stock and unsecured indebtedness, petitioner's investment in such stock and indebtedness can be considered an additional consideration for the common stock of the reorganized corporation which was issued to petitioner upon payment of First Mortgage Bonds which petitioner had guaranteed many years previous.

3. Whether the Tax Court and the Circuit Court of Appeals have the power to disregard the final decree of the United States District Court for the Middle District of Tennessee, which approved a plan of reorganization under Section 77B of the Bankruptcy Act, and which conclusively established the property rights of stockholders and creditors of the company being reorganized.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Courts below holding that petitioner received something in exchange for its stock and indebtedness, despite the reorganization Court's determination to the contrary, is probably in conflict with the fundamental reasoning in the decisions of this Court

in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, *Fairbanks* v. *U. S.*, 306 U. S. 436, and *Helvering* v. *William Flaccus Oak Leather Co.*, 313 U. S. 247.

2. The decision of the Courts below holding that a taxpayer who owns securities which share in a reorganization and also securities which do not share is precluded under Section 112 of the Revenue Act of 1936 (which is substantially the same as Section 112 of the Internal Revenue Code) from deducting a loss with respect to the securities which do not share decides an important question of Federal law which has not been, but should be, settled by this Court.

3. The decision of the Courts below holding that petitioner received something in exchange for its stock and indebtedness, despite the reorganization Court's determination to the contrary, is in conflict with the established rules for the administration of Section 112 of the Revenue Act of 1936 and the corresponding provisions of earlier and subsequent revenue laws as set forth in respondent's Regulations 94, Article 112 (a)-1, and the corresponding articles of earlier and later regulations, which regulations had acquired the force of law through subsequent enactment of similar laws by Congress without substantial change.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Third Circuit, sitting at Philadelphia, Pennsylvania, commanding said Court to certify and send to this Court on a day to be designated, a full and complete transcript of the records of all proceedings had in this cause, to the end that this cause may be reviewed and determined by this Court; that the order referred to at page 1 hereof be set aside and reversed, and

that petitioner be granted such other and further relief as may be just and proper.

THE UNITED GAS IMPROVEMENT COMPANY,

By

JOHN H. MINDS,
1401 Arch Street,
Philadelphia, Penna.,

WILLIAM R. SPOFFORD,
1035 Land Title Building,
Philadelphia, Penna.,
Counsel for Petitioner.

BALLARD, SPAHR, ANDREWS & INGERSOLL,
Of Counsel.

Dated June 28, 1944.